RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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February 6, 1991 **LETTER 1062**

DEVELOPMENTS: On January 30 the Dow surged 50 points, closing at 2713.12. This took the Dow above the 50% level (i.e., 2683) of the entire July to October decline. If the Dow can hold above 2683, the 50% Principle will have turned bullish.

My Primary Trend Index (PTI) is now within a few points of its 89-day moving average (see page 2 chart). Crossing above and holding above the 89-day MA would be bullish.

The D-J Industrials and Transports have both rallied above preceding peaks (although Utilities have lagged badly). This is a decided plus for the market (although NOT a signal for a new bull market).

If all the above had occurred within the context of a primary bull market, I would, of course, be bullish. But since they have taken place within a primary bear market, I say, "Very nice, but be careful -- bear markets can be very deceptive."

The market seems to have enthusiastically discounted a short Persian Gulf war and an early end to a mild recession. I'm afraid I'm skeptical on both counts.

On January 30, Fed Chairman Alan Greenspan resorted to the big hedge. He said that if the war lasts past mid-April, the recession could be deep and long, since an extension of the war would be very discouraging for the public. Hmm, there's obviously a good chance the war will last past mid-April, so what's Greenspan telling us? Let's look at it this way: "OK, Alan, the Fed is off the hook, so if it's a long, deep recession, we'll just blame it all on Saddam Hussein."

Martha Seger, departing (well, actually, she resigned) member of the Federal Reserve Board, stated that it will be a steep and severe recession. She also complained that the Fed was sexist and that they ignored her input and warnings for six-and-a-half years.

THE PICTURE: The Conference Board's latest survey indicates that consumer confidence has sunk to the lowest level in a decade. Since 70% of the US Gross National Product comes from consumer spending, that would ordinarily be a real worry.

But the stock market couldn't be less interested. Market sentiment seems to be that the worst for the economy has been discounted, that the war is progressing nicely, that the war may last a little longer than we had originally planned, but the outcome is obvious -- we're going to win. Furthermore, the war may even stir up some activity in the economy (wars usually do). So why worry? Finally, the stock market is rallying and there's a load of cash on the sidelines, so let's get in there and buy some stocks.

On another front, the Fed and Mr. Greenspan have obviously panicked, and they have flooded the banks with reserves. So again, "Why worry -- what the Fed wants, it will get." Well, to be honest there is one worry. The worry is that this time the problem isn't high interest rates (a situation that can be reversed by the Fed). This time the problem is illiquidity. And although the Fed can re-liquify the banking system, it can't re-liquify the cities and the states and the corporations and the American consumer.

At any rate, it's a news-oriented, rumor-run stock market. But behind the war and the rumors and the talk lies the overall power of the primary trend. Currently, the primary bear force is dormant. There's been little or no selling pressure in this market, and buyers are becoming bolder.

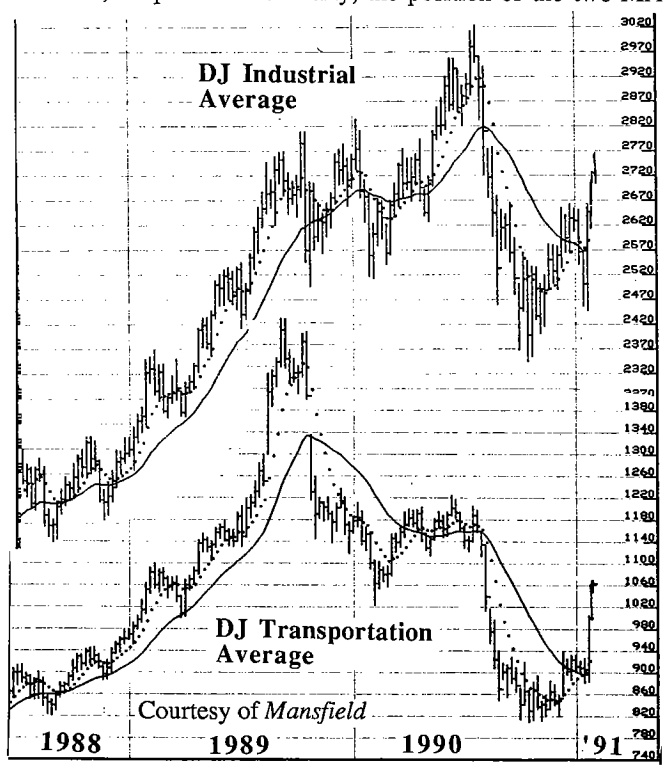
Jan. 25 DJIA 2659.40; PTI 3151; A-D Ratio -16.18
Feb. 1 DJIA 2730.69; PTI 3166; A-D Ratio -15.03
Dow Yield: 3.70%; Dow P/E: 14.4; DowPow: -448
Dow 200-day MA: 2666; Dow 30-day MA: 2592
Dow Book Value: 1276; PTI 89-day MA: 3164
Percentage of Undervalued Blue-chips: 23%

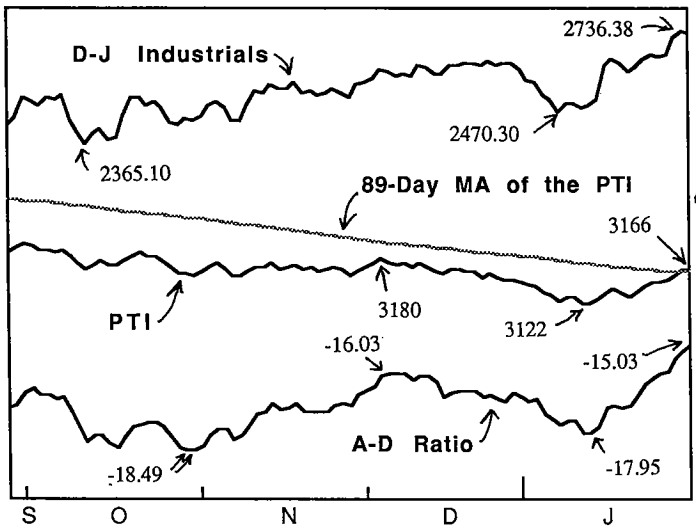
But the bear is patient and the bear has his methods. One of the bear's method is this -- when Wall Street and the public get too bearish (as they were at last October's lows), the bear eases up. He backs off. This allows investors and traders to become optimistic and buy stocks again. Which is fine with the bear. Buying stocks in a bear market is a risky (and ultimately costly business) but somebody's got to do it, and nobody's going to do it if there's too much pessimism around.

There are a few interesting benchmarks which I want to discuss now. The first entails a very basic study -- it's the juxtaposition of two moving averages (MAs) of the Dow. For this study I use an intermediate-term or 30-day MA and a long-term or 200-day moving average.

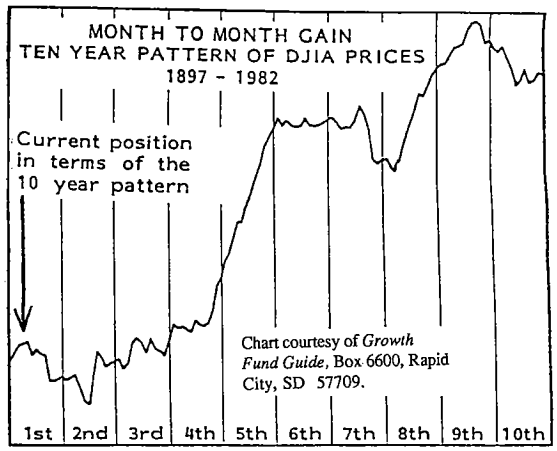
During a bear market, the 30-day moving average will normally tend to hold below the declining 200-day MA except in the case of the most powerful upward corrections. By the way, note that I always include the statistics for these two MAs on the page 1 statistic section of each Letter.

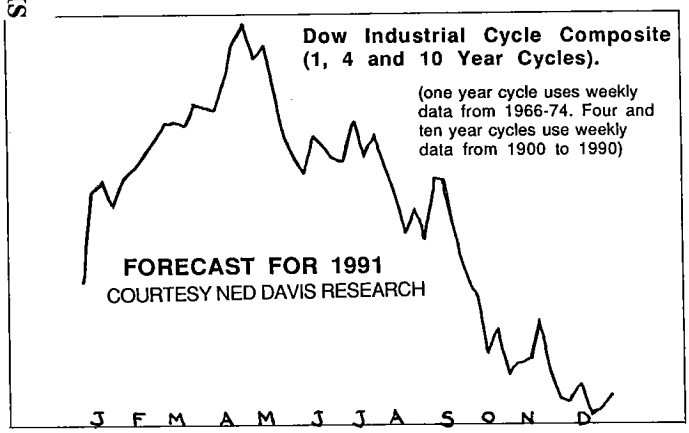
Referring to the chart on page 2, note that the Dow (now in a upward-correcting phase) is above both its 30-day MA and its 200-day MA, but the rising 30-day MA is still below the 200-day MA. Thus, despite the Dow rally, the position of the two MAs





THE PTI HAS NOW BROKEN OUT AND IS IN THE BULL MODE! THIS IS A "TRADING BUY SIGNAL."

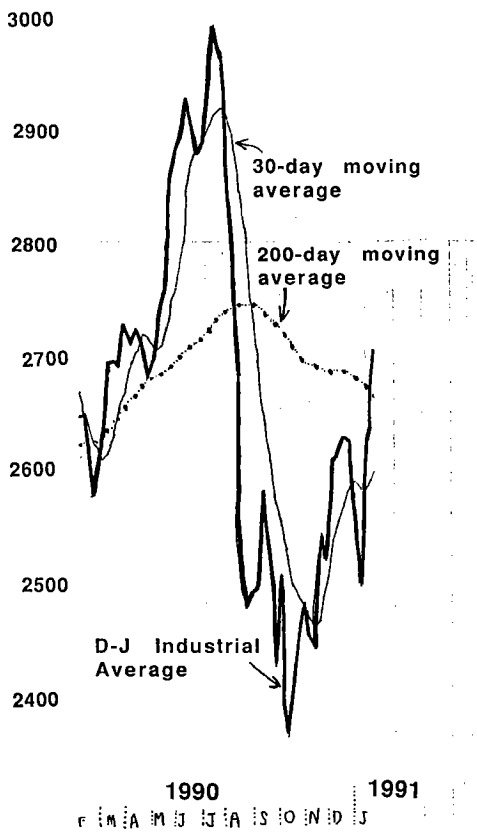



Dow Industrial Cycle Composite
(1, 4 and 10 Year Cycles).
(one year cycle uses weekly data from 1966-74. Four and ten year cycles use weekly data from 1900 to 1990)
FORECAST FOR 1991
COURTESY NED DAVIS RESEARCH
J F M A M J J A S O N D

remains bearish. To turn bullish, the 30-day MA will have to climb above the 200-day MA and the 200-day MA would have to turn up. To accomplish this, the Dow must climb above the 2683 level and hold above that level for quite some time.

What do I think? I think there's a good chance that the MAs will reverse to the bullish mode. Why do I say that? Isn't this a continuing bear market? And my answer is yes, this is a continuing bear market, but I sense that this bear wants in the worst way to turn market sentiment BULLISH. In order to accomplish that, the bear's got to let this market advance far enough and dramatically enough to turn the perma-bulls wildly bullish, to turn the on-the-fence bulls bullish, and to turn the doubters at least mildly bullish. In other words, the bear's got to rout the pessimists, and the way to do that is with upside violence and persistence.

I've warned subscribers over and over again that this is going to be a LONG bear market, that it's going to be a difficult and deceptive bear market, and that it's going to be punctuated by movements that look like mini-bull and mini-bear markets -- all this within the context of an ongoing primary bear trend. Those veteran readers who lived through 1966-74 will know what I mean.



As it's early in the new year, this is probably a good time to discuss the so-called decennial pattern. This is the pattern (cycle) which suggests that each year of a ten-year cycle (for example 1951, 1961, 1971, 1981 or 1967, 1977, 1987, etc.) tends to take the same general form.

The chart on page 2 shows the decennial pattern with an arrow pointing to where we are now. Ned Davis has taken the whole business of cycles a few steps further. In his latest report Ned includes a chart in which he combines three cycles. They are (1) the decennial pattern as discussed above, (2) the so-called four year Presidential cycle, and (3) and the one-year seasonal cycle (see chart on page 2).

The decennial pattern is probably the strongest of the three cycles. It turned down in late 1989 and continued down into mid-1990. From the mid-1990 low, this cycle then rallies into spring of 1991 -- and then declines to mid-1992. However, the decennial pattern in 1991 conflicts with the four-year Presidential cycle. The Presidential cycle suggests that the year before a Presidential election (1991 in the current case) should be strong, since it is here that the President (almost always with the help of a compliant Fed) does whatever he has to -- in order to insure his re-election the following year.

Mr. Bush ran for the presidency on a platform of no new taxes, a prosperous economy and a kinder and gentler US. Today he's behind on all counts. But Bush is now a war-time president enjoying very high popularity. How he does over the next few months will determine the validity of the Presidential cycle, at least for the year 1991.

The Ned Davis chart on page 2 illustrates his forecast for the year 1991. His forecast calls for rallying action into March-April followed by trouble for the rest of the year. Ned Davis is one of the smartest and most scholarly guys in this industry, and I suggest you keep this chart firmly in mind as the year progresses.

Ned starts out his forecast with the following statement. Investing is "a business of making mistakes -- the only difference between

the winners and the losers is that the winners make small mistakes while the losers make disastrous mistakes."

Actually, that may be another way of stating one of my own favorite market aphorisms. It's Russell's law which states, "Above all, don't lose money." I've found that if you manage your investments so that somehow you don't lose money -- then voila, you're going to make money. And believe me, if you make money in this business you'll be ahead of about 80% of all the investors and stockholders in the nation. The awful truth is that most people, over any considerable length of time, lose money in the markets (and I don't care if they lose it in stocks, bonds, metals or commodities).

INVESTMENT POSITION: My friend, James Grant, in his latest report, states that for years "the federal funds rate was the world's greatest interest rate. It was the fulcrum rate of interest in the world's leading economy. It was the interest rate that, more than any other, bore the stamp of the Federal Reserve Board. Not this year though. The 1991 interest rate of the year is not our old friend but the three-month Deutsche mark deposit rate."

I agree with Jim Grant. I also agree with him when he states that the three-month Deutsche mark rate "is the benchmark money-market rate in Europe. It is the principle source for the competition (as we happen to think) for gold." And here too, I agree.

The three-month rate for the Deutsche mark is 9.5%, which is a very attractive rate. Subscribers may remember my oft-repeated observation that over a long period of time the average money manager generates a total return of roughly 10% on all his activities. So on that basis, a guaranteed 9.5% is attractive indeed.

Of course, if you buy time deposits or money market instruments in any non-dollar denominated vehicle, your investment will fluctuate against the dollar. Nevertheless, I feel that diversification out of the dollar is definitely warranted today.

Canada, Britain, all the Anglo Saxon countries are now in recession. Unemployment in Canada has climbed to 9%. The Canadian dollar and the pound have been strong (probably because they have been paying fat rates). But with the recession, they will be bringing their rates down, and when they do, their currencies should come down too.

The German mark has been holding near its highs, but Germany is next to Russia and has big investments in the Soviets. I like the mark, but the Russian situation worries mark-holders. If Gorby goes under, the mark could get hit.

The Swiss franc is near its highs, and I like it, but it will tend to move in the band with the German mark.

Current stance: I don't like the dollar, and I particularly don't like it long-term. But at this particular time, with the war on and the Soviet situation in flux, the dollar, temporarily, is not a bad place to be.

European rates up, US rates down, the Fed fighting the bear, the dollar nearing record lows -- late comments about all this on page 6.

A LIFE OF ITS OWN: Back in the 1920s Karel Capek (the great Czech playwright) wrote a play entitled "R.U.R.". The play (which ran on Broadway and in road companies all over the nation) was widely acclaimed and became a classic. R.U.R. stands for Rossum's Universal Robots, and the story is this: Rossum, a scientist, creates robots that are highly sophisticated. The robots learn how to think and to multiply. In time they become the masters of their human creators. The robots become a menace, and in time they take over and destroy the human race. In other words, Rossum's creations take on a life of their own -- the creation overpowers and destroys its creators.

This idea of man's creation taking on a life of its own, and then overpowering man himself has always fascinated me (the Frankenstein scenario). We see this "life of its own" syndrome in disease in the form of cancer. The body's own creation, cancer, grows and gradually overpowers its host. If not checked, the cancer will destroy the very body that created it.

I believe that this same process tends to occur with governments. Consider Communism. Communism was a concept that was tried on a massive scale in the Soviet Union. Communism became a monster which, in time, took over the heart and soul of the Soviet people. Communism destroyed almost everything it touched. Now we see the Soviet people trying to break away from Communism, even though this soulless monster is reluctant to relax its grip. In other words, the concept, Communism, literally took on a life of its own.

And I wonder whether Democracy may not eat itself up in time. The deterioration process started, I believe, when the people found that they could vote themselves a piece of the other person's earnings and possessions via new laws and confiscatory taxes. The deterioration process continued when the people realized that they could vote themselves a higher standard of living than their production and savings warranted -- simply by borrowing from the future.

Finally, the process progressed even further when Congressmen and Senators perceived that there was great power, prestige and money in becoming life-long "dynasty politicians" rather than citizen-statesmen (the latter, of course, was the original intention of the Founding Fathers).

All of which brings me to one of the great cancers of modern times. It's the financial cancer of DEBT. Created by the people themselves, debt has become the modern "universal robot," the monster that is eating this nation up alive. The frightening fact is that over recent years, rising, compounding, multiplying debt in America has literally taken on a life of its own.

THE FUTURE OF DEBT: For years I have been trying to show subscribers what the debt and deficits will mean in terms of the future, both for the nation and for the dollar. One of the few people in the country who has been talking along the same lines is Harry Figgie, CEO of Figgie International, headquartered in Willoughby, Ohio. In a report to *Investor's Hotline* (10616 Beaver Dam Rd., Hunt Valley, Md 21030) Figgie states that by the mid-1990s the US will be paying $335 billion a year in INTEREST on the federal debt (which would be larger than our huge military budget).

Figgie notes that the US is close to the point of not being able to reverse the situation, no matter what is done in the way of taxes. If there is no real resolution by 1995, states Figgie, debt will be created so fast and the deficits will be so large that the US will be forced into hyper-inflation.

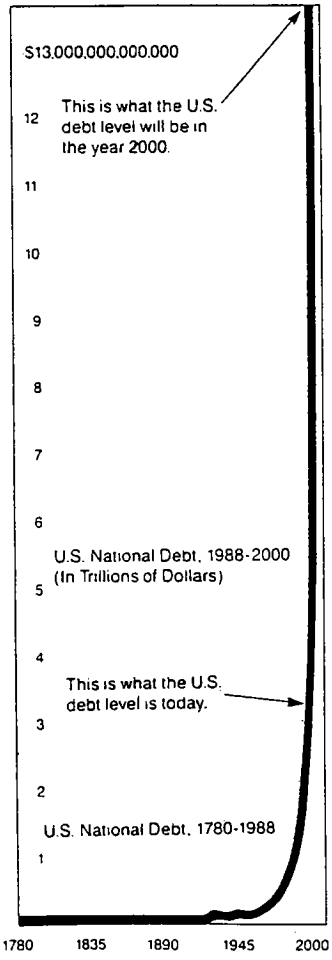
Figgie presents this horrific chart showing the projected path of the federal debt level, assuming we go the way we have been going. His figure is $13 trillion in federal debt by the year 2000. Figgie also notes (as I have for many months) that the real deficit level is over $400 billion a year, and that the government's phoney figures have been hidden via nine government trust funds.

What these deficits have done can be seen in the recent history of the dollar. From its all-time high recorded in February 1985, the trade-weighted dollar has dropped 50%. This means that in terms of other major currencies, the dollar has now lost roughly half its value.

US finances are out of control and the dollar is the barometer. Up to recently, the world has been accumulating dollars or at least buying dollar denominated items (such as US Treasury bonds). Now we are at the phase where the world has pretty much halted its buying of

dollar denominated items. Next: we could be entering the phase where the world ACTIVELY SELLS dollar denominated items. At that point, US debt will be the financial equivalent of R.U.R. -- Rossum's Universal Robots.

All of this has great long-term significance for bond holders. Comstock Partners were huge holders of T-bonds. They have reversed their stance, and here's what they wrote in the semi-annual report for their Strategy Fund: "As debt liquidation spreads throughout the country, our government will need to stand behind any defaults and foreclosures it has guaranteed through its $5.7 trillion in safety nets. The process will call for public sector refinancings of tremendous magnitudes. Moreover, this new type of debt growth will not stimulate the private sector because it just replaces money which was tossed down a black hole (e.g., lost in the S&L debacle) rather than applied to productive purposes . . . When a liquidity crisis looms, financial malaise takes out the weakest links in the debt chain first (i.e., junk bonds and lower-rated corporate and muni debt), then works its way up the credit quality ladder to Treasury debt. The fact that Treasury debt is no longer insulated from the malaise impelled the major change in our investment thesis."



FULLER: Enclosed with this Letter is a flyer describing the excellent market letter written by my friend, David Fuller. I have never included a flyer about another service before, but I feel that *FullerMoney* is one that will interest my readers. This is a truly international report covering world markets, world currencies, world economies. David also includes much excellent investment advice plus Fuller's own original and highly informative comments (many point & figure charts in each letter). It's a top report, one of the few that I read from start to finish.

NOTES & QUOTES: Doubts: For what it's worth, I'm having increasing doubts about the wisdom of this war. Ideally, the US "should have had" a well-defined energy policy (currently, we have no energy policy at all). Ideally, I feel the US (like France which is 70% nuclear) should now be far less dependent on oil for energy. Ideally, the US should have developed sun power, wind power, wave power, coal power, shale oil power. We never did.

Now we're at war, and I'm worried about a rising Islamic backlash, and that in time, most of the "poor Islamic world" (that includes 98% of all Arabs) will turn against us.

I've written before, but I'll repeat it -- I believe the two worst disasters in US history were (1) the Vietnam War, and (2) our policy of deficit financing. I hope the war in the Persian Gulf isn't going to be the third.

* *

Fred Trump (Donald's father) came to his son's aid in making the $18.4 million interest payment on Trump Castle. But dad did it in a very unusual way. He bought $3 million in Castle casino chips and actually carted them off. Thus, he has first line collateral. If dad Trump wants his money back, he just goes to the Castle casino window and cashes in his chips.

* *

The trouble in the Soviet Union continues to fester. Gorbachev jettisoned the old system (well, most of it), but he never instituted a new system of free market. Now Gorby stands astride the two beasts -- the army and the KGB. In March, matters may come to a head, since at that time the last of the food will have been eaten, and the fear is that western food shipped to the Soviets will all go to the two beasts rather than the people. There is talk of civil war, but I keep thinking that maybe, just maybe, things may work out. But I don't think they can work out with Gorbachev; he's still basically a Communist, and he still can't let go of the central planning concept. From the standpoint of Western businessmen, the loss of any central command means that laws made in Moscow may not be carried out in the republics. Foreign businessmen complain that you just can't get anything done in Soviet Russia.

A few weeks ago the Soviets suddenly decided to call in all 50 and 100 ruble notes. This was ostensibly to cut the money supply which has been booming amid wild inflation (inflation because mounds of paper rubles are chasing nothing -- there are no goods to buy). The ruble call-in has wiped out many people and caused fear, anger and hysteria in the Soviets . . . The official ruble rate is six to the dollar, but on the black market it's 20 rubles to the dollar. The average Soviet worker makes 267 rubles a months. In terms of black market dollars this amounts to exactly $13.35 a month! In terms of Deutsche marks or Swiss francs, well, you don't even want to think about it.

* *

The Korean War (1950) was financed with increased taxes. In the post-War period there was no inflation and the economy boomed. The Vietnamese War was never really financed. LBJ waited a year before proposing a tax boost, and Congress waited another 18 months before instituting a war surtax. The result was high inflation and rising deficits for years after.

This time the Persian Gulf was started with the US in recession and with deficits already going through the roof. At a Congressional hearing on January 24, a worried Fed Chairman Greenspan warned against raising taxes at this time, and he emphasized that the situation today and at the outset of Vietnam are very different. So Greenspan is advocating fighting the war now and paying for it later. What else is new?

Fed Chairman Greenspan hopefully states that the war will cost "several hundred million dollars a day" and that it "may be a lot lower than we realize." Of course, no one has any idea how much the war will cost because no one knows how long it will last nor what will be involved. General Westmoreland of Vietnam fame stated two weeks ago that the war shouldn't last much longer than a year. Lovely.

Costs: In 1981 dollars World War I cost $380 billion, WWII cost $3.1 trillion, the Korean War cost $265 billion, the Vietnam War cost $570 billion. Early estimates say the current war will cost $23 to $86 billion, depending on how long it lasts. My guess -- over $100 billion, although the US may only (hopefully) pay half. The war will also start up some expensive new defense programs.

* *

The new hot book to be published soon is "Elizabeth and Phillip, the Untold Story of the Queen of England and Her Prince" by Higham and Moseley. Among the revelations: Queen Elizabeth is worth $18.5 billion with some of her money having been made in US investments. The Queen, reputedly a brilliant investor, has holdings in oil, textiles and real estate. The Queen owns one of the largest cotton plantations in the world -- in Mississippi.

* *

Back in 1987 through '89 I stated that Wall Street would be the first to go into recession/depression and in due time the rest of the nation would follow. The depression on Wall Street continues. Despite the many thousands who have been laid off in Wall Street, the consulting firm of Booz-Allen and Hamilton estimates that as many as 60,000 additional people in securities firms will be laid off over the next year or two in order to bring Wall Street firms' costs down to manageable levels. Since the '87 crash, 947 securities firms (most of them small) have folded, bringing the total number of registered firms (NASD) down 14% to 5,780.

* *

And I thought all this was new. I opened up the latest (Feb/Mar) copy of *American Heritage* magazine (I love this magazine), and there's an article entitled, "Understanding the S&L Mess." The piece starts, "Bank failure is as American as apple pie. The first American failure took place in Rhode Island in 1809, when a bank capitalized at $45 issued eight hundred thousand dollars in bank notes, a sum equal to more than seventeen thousand times the resource behind it . . . The 182 years between 1809 and 1990 have been marked by literally tens of thousands of bank failures. In sharp contrast, Great Britain, whence most American banking theory and practice comes, has not had a major bank failure in well over a hundred years." Russell comment: banking is a very strange business. Have you ever considered this? As opposed to other businesses, cash on hand at a bank is a liability since it is owed to someone else, the depositors. But loans made by the bank are an asset, since the loans are owed to the bank.

* *

Live and Learn Dept: I just read a school paper written by my ten-year old daughter, Lauren. The subject was the Star Spangled Banner, and I was amazed to learn that although Francis Scott Key wrote the words, the tune was taken from a popular English song of the time called "Anacreon in Heaven." And I had always thought that Key wrote the words and the tune. Amazing.

* *

And here's the latest: The bad news is that Jane Fonda is going to Iraq. The good news is that Teddy Kennedy will be driving her there.

* *

People and nations tend to be guided and influenced by their most recent experience. Germany was nearly destroyed by WWI and again by WWII. As a result, today's Germany is violently opposed to being involved in war. Germany, Europe's most powerful state, has chosen to remain as far away from the Persian Gulf conflict as possible. Last fall Germany pledged $2.2 billion to the allied war effort, but giving any more is proving to be a political problem, and the German people as a whole don't want any part of the war. The Kohl government interprets their Constitution as barring any direct German military role in the Gulf. Japan is watching Germany closely, and Japanese sentiments toward the war are pretty much the same as Germany's.

* *

Golden State? A new study indicates that one out of every seven large corporations plans to leave the state of California. If you live here you know why -- high housing prices, crowded freeways, smog, high crime, very high state taxes, state red tape for businesses, and last but not least, a coming $10 billion state budget deficit, with all that implies (could state taxes possibly be going higher?) . . . Speaking of California, day after day we're enjoying beautiful blue skies and sunshine. Blue skies are great, but this is also the fifth year of drought in the state, and it's finally developing into an emergency. So far in '91, rainfall has been 20% of normal (and "normal" is only around 10 inches). Water officials say that there will be less rain this year than 1977, which was a particularly bad drought year. In San Diego, they're preparing for a 31% cutback in water use. The water level at Lake Tahoe has dropped to its lowest level on record.

* *

Noting the fat increases in Congressmen's salaries and budgets (see Letter 1060), an irate subscriber (CEO of a S&L, no less) writes to inform me that among other things, Congress is spending $375,000 for renovation of the House beauty salon and $250,000 to study the best placement of TV lighting in the Senate committee rooms! "I agree with you," he comments, it's "outrageous."

* *

Usually happy *Forbes* magazine is bothered (as I've been for lo these many years) by debt. In the latest issue (Feb. 4) an article entitled "An Excess of Plastic," begins as follows: "The government is deeply in debt, many corporations are deeply in debt, and the American consumer is in hock. American consumers owe $3.2 trillion on credit cards, car loans and mortgages; the average household owes about $35,000 and pays interest of about $3500 a year. Nearly 18% of consumer disposable income is eaten up servicing that debt . . . In 1988 personal bankruptcy losses totaled $12 billion." Russell comment: the picture would be totally fascinating if it weren't so sick and tragic, but this is the situation the Fed faces as it lowers interest rates and attempts to spur consumers to lighten up, stop worrying and buy more. Will it work? That's the fascinating part of it -- Nobody knows? In the end, in my opinion, it won't work, and the bear will have his way. But as I wrote a few years ago -- when the recession hits, "the government and the Fed will fight it tooth and nail."

* *

Paul Kennedy, author of the much discussed book, "The Rise and Fall of the Great Powers," wrote a rather ominous letter to the *Wall Street Journal* (Jan. 24). In his book, Kennedy warned of great powers that have overstretched themselves and then gone down hill. His *WSJ* letter is entitled, "A Declining Empire Goes to War." In the letter, Kennedy writes that his concern is with the future "if the trends in national indebtedness, lower productivity increases, mediocre educational performance and decaying social fabric are allowed to continue at the same time that massive American commitments of men, money and material are made in different parts of the globe. Like the late Victorians, we seem to be discovering ever-newer 'frontiers of insecurity' in the world that we, the number one power, feel impelled to guard." Russell translation: The US is not in great shape, we can't police the world, and we sure can't afford this war.

* *

Oil in Mongolia: Last month Exploration Associates of Houston, a consulting firm, published a report based on 15 previous exploratory studies in Mongolia, explorations by German, Soviet, Hungarian, Romanian and Polish geophysicists. Evidently, there's a lot of oil in Mongolia, and the report has become a best-seller among US oil companies. Cost of the report -- $45,000 a copy. One NY oil company has already formed a $50 million joint venture with Mongol Gazryn Tos, a Mongolian petroleum company. Russell comment: I should be writing about oil, not the stock market.

* *

Danielle Steel is the most published author in the world with 150 million of her romantic novels now in print. Steel has been married three times, has nine kids, and has an income of $25 million a year. She claims she spends 10 hours a day writing, 10 hours with her kids, sleeps four hours a day. Wotta woman! The Steel formula -- strong women and stronger men -- trouble and conflict, then romance, money, success, and always a happy ending. Now you know.

* *

This has been a very rough year for magazines and newspapers. Circulation of most of them is down and (worse) their advertising income is also down. I'm doing my part to help the industries since I subscribe to 10 daily newspapers and -- well, I'm also a magazine-a-holic, and I've lost track of the number of magazines I subscribe to. Last week I saw a rundown on magazine income, and I was a bit surprised. Most of them are down on the number of advertising pages they sold. But the biggest rise was in *Entrepreneur* (I've never seen this one) up 35% in advertising revenue, and the second biggest pop was *The Economist* up 30% in revenue. *Forbes* was up 11% and *Good Housekeeping* was up 15%. *The Economist* (out of London) is, in my opinion, by far the best financial and news magazine published anywhere at any price, and I've been recommending it to my subscribers for years (*The Economist*, PO Box 50400, Boulder, CO. 80321 -- $98 per year, published weekly). Finally, congratulations to my friend, Chris Wood, who has just moved to Tokyo via his new position as the *Economist's* Japanese correspondent.

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Japan: Although most people are unaware of it, probably the biggest question mark in the entire world economy today is the question of Japan's real estate values. Many consider the fantastic rise in Japanese land prices to be every bit the equal of the stock market's wild rise during 1928-29. Why the worry? Because a huge portion of the rise in Japanese stocks has been built on top of the boom in real estate values (real estate was the collateral for much of the stock purchases).

The fragility of the situation has worried the Japanese authorities, and they are now trying to engineer a "soft landing" for Japan's real estate. In other words, the authorities are attempting a

"controlled deflation" in real estate prices. So far, Japanese land and real estate prices have come down about 10%, more in some of the outlying districts of Tokyo. But whether the Japanese can bring down prices further without upsetting the apple cart remains to be seen. Remember, Japanese real estate is up on a gigantic stilt formation pricewise, and stilts, as a rule, do not float back to earth. They tend to crash.

Already the decline in real estate has had a very negative effect on the Tokyo stock market. Last year from high to low the Nikkei stock average lost 48% of its value. As I see it, Japan (like the US) is in the earlier stages of a major bear market. But I want to stress this point -- one of the WEAKEST links in the global economic picture is the still sky-high price level of Japanese real estate. If their real estate market crashes, it will have bearish repercussions that will be heard around the world.

GOLD, MONEY: The dollar has been hit hard and it's currently within a fraction of its record low. Meanwhile, the Deutsche mark and the Swiss franc continue to flirt with their highs. Recently, each time these two hard currencies appear ready to break out to new highs, selling seems to materialize, and the currencies back off. The word is that the US Treasury or the G-7 nations (or both) have been manipulating the market, buying dollars whenever it appeared that the dollar is in danger of breaking to new lows (the need for intervention is always a sign of weakness). Ultimately the primary (bearish) trend will prevail.

Meanwhile, gold has been weak. On January 30 gold dropped below 370, but the metal is still well above its low of 346. Last week the CRB Commodity Futures Index (21 commodities) broke to the 213 level, lowest level in 14 years. That commodities could act this poorly during war time is absolutely extraordinary (wars are almost always inflationary in that they trigger all-out spending for food, medical supplies, munitions).

In a special January 23 report entitled "Gold, Comeback Investment of the Year?" the highly respected *Bank Credit Analyst* notes, "Gold is very underpriced relative to the rise in US foreign indebtedness. Keep in mind that all US public and private debt is denominated in US dollars. In other words, debasing the dollar does not directly penalize the US by increasing debt servicing costs, unlike the situation in Australia or Canada. While foreign creditors will not tolerate currency losses forever, there is a lot of domestic pressure on the US authorities to ease massive domestic and foreign debt burdens. A lower dollar and lower rates are inevitable . . . The areas of greatest excesses in the 1980s are currently suffering the greatest deflation and are threatening the financial system. Banking problems would be greatly alleviated if real estate prices rose rather than fell. The pressures to avoid a debt deflation similar to the 1930s is intensifying each month in the US and will reach a crisis point by mid-year if economic activity continues to contract."

The Fed (almost in a state of panic) is now rushing to re-inflate the economy via boosting bank reserves and lowering interest rates. If the Fed's re-inflation policies are successful, gold should enter a new bull market (in the new inflationary environment). The stock market's rise is obviously based on Wall Street's perception that the Fed will be able to "reflate the economic balloon."

In previous Letters I listed a number of ways of diversifying out of dollars. Add this one to the list -- Huntington Advisors, 1-(800) 826-0188 or (213) 681-3700. They run three foreign currency funds and all three provided total returns in 1990 of above 15.6%. For large amounts in foreign time deposits (amounts above $250,000), you might call Kirk Michie of the Swiss Bank Corp. in LA at (213) 680-5257.

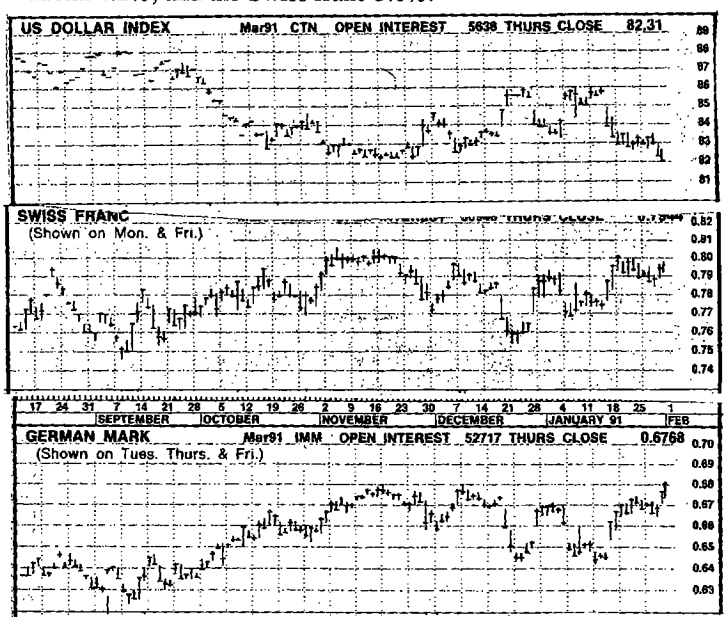
LATE NOTES: Last week the fiercely anti-inflationary Bundesbank raised both the German discount rate and the Lombard rate 1/2% each to 6.5% and 9% respectively (the Lombard rate is the rate at which banks can borrow unlimited amounts from the Bundesbank). Since the Deutsche mark is the key currency of Europe, other nations followed. The Dutch lifted their discount rate from 7.25% to 7.75% and the Austrians boosted their rate from 6.5% to 7% and their Lombard rate to 9%.

In a demonstration of the fear which must now be enveloping the Federal Reserve Board, the Fed on February 1 lowered the discount rate 1/2% to 6%. Thus, the spread between the US 90-day money (T-bills) and 90-day time deposit money in the major European currencies is huge (the spread on three-month deposits in Deutsche marks is pushing 4%).

The question is -- what's holding the dollar up at all? And the answer, I think, is threefold. First, the dollar underwent a huge slide in 1990, it was very oversold. Therefore, it is now working out of its oversold condition. Second, I believe there is intervention by the US Treasury and possibly the G-7 nations, intervention in an attempt to support the dollar. Finally, on a purchasing power parity basis, the dollar is cheap (although history shows that PPP has never been a great guide to the direction of a currency).

My own guess is that when the current oversold condition of the dollar is worked off, we will see the dollar sink to new lows against the major currencies (with it all, subscribers who have taken my recent advice to buy marks, francs and ECUs have done well, and should now show nice profits plus fat interest payments).

These charts from *Investor's Daily* show the relative position of the mark and the franc plus the US Dollar Index. The Dollar Index consists of weighted amounts of 10 foreign currencies, being the German mark 20.8%, the yen 13.6%, the French franc 13.1%, the pound 11.9%, the Canadian dollar 9.1%, the Italian lira 9.0% and the Dutch guilder 8.3%, the Belgian franc 6.4%, the Swedish krona 4.2%, and the Swiss franc 3.6%.


US DOLLAR INDEX Mar91 CTN OPEN INTEREST 5639 THURS CLOSE 82.31
SWISS FRANC
(Shown on Mon. & Fri.)
17 24 31 7 14 21 28 5 12 19 26 2 9 16 23 30 7 14 21 28 4 11 18 25 1
SEPTEMBER OCTOBER NOVEMBER DECEMBER JANUARY 91 FEB
GERMAN MARK Mar91 IMM OPEN INTEREST 52717 THURS CLOSE 0.6768
(Shown on Tues. Thurs. & Fri.)

Stock Market: The Fed is now obviously "fighting the bear market tooth and nail," and it has lowered the discount rate despite dollar weakness and despite the huge disparity between US and foreign rates. Meanwhile, the stock market acts as if the Fed's action will trigger "a new bull market." This is what I think will happen -- there may be a temporary easing of the recession. In other words, there may be a let-up of the bad news, and at that point many will proclaim that the recession is over.

I think that will be the fooler. The recession will not end quickly, and prosperity will not automatically return in response to Fed easing (as was the case in previous recessions). My feeling is that there may be a slight easing of the recession, but toward the fall, it will be seen that the recession is deepening again. On top of that I think the early successes in the war are stirring up optimism, and this optimism is rubbing off on the stock market. But the war is not the problem -- the lack of liquidity in the economy and the credit squeeze are the problems. The bear market will be a marathon affair, not a sprint -- unfortunately.

NEXT MAILING: February 20